Developing and Implementing
A Successful Succession Plan

"To Plan or Not to Plan... That is the Question!"

I. Elements of an Effective Plan

A. Criteria
* What do you want to accomplish?
* Is your small business a "hobby" or a "business?"

B. Time Frame
* When to start your plan.
* Knowing where you are in the small business life cycle.

C. Players
* Who is involved in the decision making?
* Who will be affected?
* "People support what they help create."

D. Advice and Assistance
* SBA
* Local resources: S.C.O.R.E., SBDC's.
* Local professionals: accountants, lawyers, and bankers.
* "Asking for help is not an admission of failure!"

E. Evaluation
* When will you know that you've made it?
* Without a plan, you won't know where you're going or how to get there.

II. Putting the Pieces Together

A. Define Owner/Founder Goals and Business Goals
* What do I want as my business grows?
* Do I have a vision of the future?
* Have I communicated the vision to others?

B. Analyze Your Business
* Structure
* Market
* Operation Policies
* Personnel
* Financial Condition

C. Create an "Advisory Team" to Help Create/Sell/Implement the Plan
* "Two Heads are Better than One -- Three Heads Improve the Vision."
* Staff for Strength -- Marketing, Legal, Financial, Insurance.

D. Develop a Time Line with Key Steps
* Keep focused on the ultimate goal -- the perpetuation of your business and personal financial security.

E. Determine If Owner/Founder Goals Differ from Business Goals
* Does the business drive the owner or does the owner drive the business?

F. Analyze Owner/Founder's Personal Assets, Estate Plan, Life Mission
* Do individual goals clash with family or business goals/needs?

G. Be Mindful of the Possible Outcomes of Your Plan
* Who will be affected -- to what extent?
  - ✓ Family members.
  - ✓ Stakeholder(s).
  - ✓ Market.
  - ✓ Employees.
  - ✓ Competitors.

H. When/How Will You Communicate Your Plan?
* Information minimizes confusions, distrust, uneasiness.

I. Examine Your Plan from a Strategic View
* Strengths. * Weaknesses. * Opportunities. * Threats.

J. Create Measures to Evaluate/Provide Feedback
* Should be:
  - ✓ Concrete
  - ✓ Specific
  - ✓ Measurable

K. Passing the Reins
* Have a transition period.
* Mentor the new leader (s)

III. Implementing a Plan to Pass the Business to the Next Generation

A. Determine Goals/Objectives
* Do you want to give up control?
* Can you continue to manage daily operations?

B. Determine What is Best for You and the Business
* Is it time to "pass the baton?"
* Are you and/or your business being hurt by remaining on?

C. Examine Goals/Objectives of Family Members
* Will they continue to wait for "their time?"

D. Avoid the Pitfalls
* Family tensions.
* Lack of personal financial security.
* Selecting an inappropriate successor.
* Setting up the successor to fail.

E. What to do When It's Time to Move On
* Solicit objective input from advisors, family, business associates.
* Set up criteria for successor.
* Communicate decision to all parties.
* Create clear agreement with successor to address steps, time lines, and financial considerations.
* Begin relinquishment of control.
* Set up program to mentor, train, educate successor.
* Implement the financial agreement with the successor.
* Turn business over to successor.
* Create vehicle to allow you to "keep in touch."

IV. Planning for the Sale of a Business

A. What Are the Owner's Personal Goals

* Consider retirement/using the business to provide security for the family, etc.
* Key issue: how does the business fit within those goals?
* Will the owner be able to will/gift the business to the family?
* Is owner dependent business income for costs of living?
* Does owner have resources to live independent of the business?

B. In Most Situations the Owner is Dependent on the Business

* Owner must continue to work or it must be sold (cashed out).

C. Determining Accurate Business Value is Key

* Once value is determined, compare to owner's goals/needs.
* Supplemental steps may need to be taken.

D. Steps to Take for Any Sale Plan

* Determine and groom an appropriate successor.
* "Sell" the plan to the appropriate parties.
* Determine appropriate sales method:
  - ✓ Cross purchase (agreement between owners);
  - ✓ Redemption (agreement between owners/business);
  - ✓ "Wait and see, buy-sell (Buy-sell is in place but method determined at a later date).
* Execute binding buy-sell agreement that can handle all contingencies:
  - ✓ lifetime sale;
  - ✓ sale at death;
  - ✓ sale in case of disability.

E. If Business Value Cannot Support Goals, Consider Alternatives

* Remaining with the business, drawing salary beyond normal retirement.
* Issues in this situation:
  - ✓ Will owner pass operations management over/continue to draw salary?
  - ✓ Will owner completely release control of business or interferes with daily operations?
  - ✓ Will management retain dollars for expansion/investment, while passive owner pulls cash from company?
  - ✓ What impact will this have on the business value?

F. Other Alternatives

* Selling company/receive rental income from company land?
* Reaching negotiated agreement/roles passive owner and management will play.
* Selling the business through an installment sale.
* Owner may draw dollars during working years and invest to lessen dependence on the business value:
  - ✓ qualified plans;
  - ✓ non-qualified plans;
  - ✓ private pension plans (executive bonus);
  - ✓ split dollar arrangements;
  - ✓ on-qualified deferred compensation.

VI. Financial Considerations of a Succession Plan

A. Succession Plan Must Address Financial and Tax Issues

* Without a funded succession plan, any approach can be tenuous.

B. Three Basic Approaches

* Sale
* Gift/Will
* Liquidation

C. Liquidation is Least Advantageous

* Business being dissolved, fewer dollars received than from the business as a going concern.
* Dollars come from the value of tangible assets.
* Nothing is received for the value of the ongoing enterprise.
* Usually only taken where there is little likelihood of sale/no heirs to take over the business.
* Wherever possible, owner should have alternative resources for retirement as the liquidation value may prove insufficient.

D. Potential Buyers of the Business

* Co-owners.
* Family members (who also might receive shares as gifts).
* Third party/competitors

E. Methods Used to Sell the Business

* Cash
  - ✓ One time payment or installments;
  - ✓ Generally, dollars come from the business or from buyer's assets or salary.
* Borrowed funds
  - ✓ effect same as cash to seller;
  - ✓ buyer must pay interest to a lender (as opposed to interest to the seller under an installment sale).
* Sinking fund.
  - ✓ dollars set aside in investment account, allowed to grow.
  - ✓ avoids interest payments with borrowed funds or installment sale.
  - ✓ asset growth taxable/may be insufficient in the event of a premature sale (due to death, disability, etc.).
* Insurance.
  - ✓ premium payments can take the place of a sinking fund;
  - ✓ can be permanent or term insurance;
  - ✓ permanent insurance provides tax deferred cash value growth
  - ✓ cash value can be used for a down payment;
  - ✓ "self completing" in the event of a premature death;
  - ✓ disability income buyout can handle disability issues.

F. Buy Sell Agreements Take Two Basic Approaches

* Cross Purchase
* Redemption - Choosing correct approach involves:
  - ✓ specific company/owner needs/goals;
  - ✓ income tax consequences;
  - ✓ gift/estate tax consequences;
  - ✓ alternative minimum tax.

G. Gifting/Willing a Business in Family Situations

* Relative may need to buy out parent to ensure parent retirement funds.
* When parents can afford to gift/will the business to their child, they must consider:
  - ✓ the parent will often try to balance inheritance received by children not involved in the business;
  - ✓ are there sufficient assets to do so;
  - ✓ is there a need to "create" an estate to will to those children;
  - ✓ often done with insurance options.
* Parents must consider estate tax issues.
* Businesses often large illiquid assets/difficult to sell before estate taxes are due.
* Insurance can handle estate taxes/allow less pressured sale.
* May be gift tax due if parents gift business to children.
* Option to wait until death and will the business.
* Raises issues related to retaining control (and management) if the older generation keeps control of the business interest.